



Saudi Telecom Company
a Saudi Joint Stock Company

**Consolidated Financial Statements for the
Year Ended December 31, 2016**

Saudi Telecom Company (a Saudi Joint Stock Company)
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**AUDITORS' REPORT TO THE SHAREHOLDERS OF
SAUDI TELECOM COMPANY
(A Saudi Joint Stock Company)**

Scope of audit

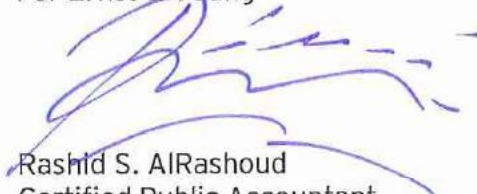
We have audited the accompanying consolidated balance sheet of Saudi Telecom Company - A Saudi Joint Stock Company (the "Company") and its subsidiaries (the "Group") as at 31 December 2016 and the related consolidated statements of income, cash flows and changes in equity for the year then ended. These consolidated financial statements are the responsibility of the Group's management and have been prepared by them in accordance with the requirements of the Regulations for the companies and submitted to us together with all the information and explanations which we required. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the Kingdom of Saudi Arabia. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable degree of assurance to enable us to express an opinion on the consolidated financial statements.

Unqualified opinion

In our opinion, the consolidated financial statements taken as a whole:

- i) presents fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2016 and the consolidated results of its operations and its cash flows for the year then ended in accordance with accounting standards generally accepted in the Kingdom of Saudi Arabia.
- ii) comply with the requirements of the Regulations for Companies and the Company's by-laws in so far as they affect the preparation and presentation of the consolidated financial statements.

For Ernst & Young


Rashid S. AlRashoud
Certified Public Accountant
Registration No. 366



Riyadh: 22 Jumad Awal 1438H
(19 February 2017)

Saudi Telecom Company (a Saudi Joint Stock Company)
Consolidated Statement of Financial Position as at December 31, 2016
(Saudi Riyals in thousands)

	<u>Note</u>	<u>2016</u>	<u>2015</u>
<u>ASSETS</u>			
Current assets:			
Cash and cash equivalents	3	3,594,467	4,504,046
Short-term investments	4	15,002,113	16,802,175
Accounts receivable, net	5	18,460,545	11,796,090
Prepayments and other current assets	6	3,321,726	3,886,566
Total current assets		40,378,851	36,988,877
Non-current assets:			
Investments accounted for under equity method and others	7	6,718,656	6,914,011
Investments held to maturity	8	6,261,145	6,474,751
Property, plant and equipment, net	9	43,030,633	40,487,591
Intangible assets, net	10	4,393,562	4,783,107
Other non-current assets	11	823,678	1,012,772
Total non-current assets		61,227,674	59,672,232
Total assets		101,606,525	96,661,109
<u>LIABILITIES AND EQUITY</u>			
Current liabilities:			
Accounts payable	12	4,855,219	3,796,511
Other credit balances – current	13	5,545,286	4,861,815
Accrued expenses and other liabilities	14	17,782,720	12,152,978
Murabahas – current	15	1,864,027	1,903,087
Total current liabilities		30,047,252	22,714,391
Non-current liabilities:			
Murabahas – non-current	15	2,017,231	3,744,076
Sukuk	16	2,000,000	2,000,000
Provision for end of service benefits	17	4,214,023	4,075,625
Other credit balances - non-current	13	2,251,624	2,164,774
Total non-current liabilities		10,482,878	11,984,475
Total liabilities		40,530,130	34,698,866
Equity			
Shareholders' equity:			
Authorized, issued and outstanding share capital:			
2 billion shares, par value SR 10 per share	18	20,000,000	20,000,000
Statutory reserve	19	10,000,000	10,000,000
Retained earnings		35,184,606	34,652,901
Other reserves	20	(2,555,879)	(1,546,576)
Financial statements' translation differences		(2,888,322)	(2,564,989)
Total shareholders' equity		59,740,405	60,541,336
Non-controlling interests		1,335,990	1,420,907
Total equity		61,076,395	61,962,243
Total liabilities and equity		101,606,525	96,661,109

The accompanying notes from 1 to 37 form an integral part of these consolidated financial statements.

Saudi Telecom Company (a Saudi Joint Stock Company)
Consolidated Statement of Income for the Year Ended December 31, 2016
(Saudi Riyals in thousands)

	<u>Note</u>	<u>2016</u>	<u>2015</u>
Revenues from services	21	51,832,672	50,650,612
Cost of services	22	<u>(23,060,191)</u>	<u>(20,305,793)</u>
Gross Profit		<u>28,772,481</u>	<u>30,344,819</u>
Operating Expenses			
Selling and marketing expenses	23	(6,378,023)	(7,198,738)
General and administrative expenses	24	(4,430,911)	(3,852,430)
Depreciation and amortization	25	<u>(8,062,870)</u>	<u>(7,434,369)</u>
Total Operating Expenses		<u>(18,871,804)</u>	<u>(18,485,537)</u>
Operating Income		<u>9,900,677</u>	11,859,282
Other Expenses and Income			
Cost of early retirement		(401,703)	(405,703)
Losses from investments accounted for under equity method		(199,674)	(378,745)
Finance costs	26	(203,658)	(238,410)
Commissions		764,258	446,375
Others, net	27	<u>(351,298)</u>	<u>(796,777)</u>
Other (expenses) and income, net		<u>(392,075)</u>	<u>(1,373,260)</u>
Net Income before Zakat, Taxes and Non-controlling interests		9,508,602	10,486,022
Provision for zakat and taxes	28	<u>(750,797)</u>	<u>(696,844)</u>
Net Income before non-controlling Interests		8,757,805	9,789,178
Non-controlling interests' share		<u>(226,100)</u>	<u>(530,750)</u>
Net Income		<u>8,531,705</u>	<u>9,258,428</u>
Basic earnings per share from Operating Income in Saudi Riyals		<u>4.95</u>	<u>5.93</u>
Basic losses per share from losses from other operations (Other expenses and income) in Saudi Riyals		<u>(0.20)</u>	<u>(0.69)</u>
Basic earnings per share on net income in Saudi Riyals		<u>4.27</u>	<u>4.63</u>

The accompanying notes from 1 to 37 form an integral part of these consolidated financial statements.

Saudi Telecom Company (a Saudi Joint Stock Company)
Consolidated Statement of Cash Flows for the Year Ended December 31, 2016
(Saudi Riyals in thousands)

	<u>Note</u>	<u>2016</u>	<u>2015</u>
CASH FLOW FROM OPERATING ACTIVITIES			
Net income before zakat, taxes and non-controlling interest		9,508,602	10,486,022
Adjustments to reconcile net income to net cash flow provided from operating activities:			
Depreciation and amortization	25	8,062,870	7,434,369
Provision for doubtful debts	23	874,728	1,714,542
Losses from investments accounted for under the equity method		199,674	378,745
Commissions		(764,258)	(446,375)
Finance costs	26	203,658	238,410
(Gains) / Losses on foreign currency exchange fluctuation		(4,111)	17,465
Provision for end of service benefits	17	575,216	530,189
Early retirement program cost		401,703	405,703
Losses on sale/disposal of property, plant and equipment	27	131,208	360,193
Gain resulting from subsidiary acquisition		-	(90,748)
Change in:			
Accounts receivable		(7,539,183)	(4,995,943)
Prepayments and other current assets		919,287	(1,519,506)
Other non-current assets		189,094	(46,189)
Accounts payable		1,058,708	1,726,353
Other credit balances		688,192	1,298,479
Accrued expenses and other liabilities		5,547,751	4,325,178
Zakat and taxes paid		(680,701)	(585,236)
End of service benefits paid		(436,818)	(223,053)
Early retirement program paid		(359,489)	(293,023)
Net cash provided from operating activities		18,576,131	20,715,575
CASH FLOW FROM INVESTING ACTIVITIES			
Capital expenditures		(9,554,604)	(9,248,435)
Intangible assets, net		(947,846)	(1,099,973)
Investments in equity and others		(20,820)	40,266
Investments held to maturity	8	159,266	(59,718)
Short-term investments		1,800,062	(2,454,857)
Proceeds from commissions		555,023	234,583
Proceeds from sale of property, plant and equipment		33,775	851,326
Net cash used in investing activities		(7,975,144)	(11,736,808)
CASH FLOW FROM FINANCING ACTIVITIES			
Dividends paid		(8,031,468)	(8,018,959)
Murabahas, net		(1,711,564)	(1,763,239)
Acquisition of additional shareholding in a subsidiary	34	(1,619,338)	-
Finance costs paid		(148,196)	(159,644)
Net cash used in financing activities		(11,510,566)	(9,941,842)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(909,579)	(963,075)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		4,504,046	5,467,121
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR		3,594,467	4,504,046
Non-cash items:			
Financial statements' translation differences		(323,333)	(745,945)
Other reserves		(1,009,303)	(393,475)

The accompanying notes from 1 to 37 form an integral part of these consolidated financial statements

Saudi Telecom Company (a Saudi Joint Stock Company)
Consolidated Statement of Changes in Equity for the Year Ended December 31, 2016
(Saudi Riyals in thousands)

	<u>Note</u>	<u>Share Capital</u>	<u>Statutory Reserve</u>	<u>Retained Earnings</u>	<u>Other Reserves</u>	<u>Financial Statements' Translation Differences</u>	<u>Total Shareholders' Equity</u>	<u>Non-controlling Interests</u>	<u>Total Equity</u>
Balance at December 31, 2014		20,000,000	10,000,000	33,394,473	(1,153,101)	(1,819,044)	60,422,328	906,282	61,328,610
Net income		-	-	9,258,428	-	-	9,258,428	-	9,258,428
Dividends		-	-	(8,000,000)	-	-	(8,000,000)	-	(8,000,000)
Other reserves	20	-	-	-	(393,475)	-	(393,475)	-	(393,475)
Financial statements translation differences		-	-	-	-	(745,945)	(745,945)	-	(745,945)
Non-controlling interests		-	-	-	-	-	-	514,625	514,625
Balance at December 31, 2015		20,000,000	10,000,000	34,652,901	(1,546,576)	(2,564,989)	60,541,336	1,420,907	61,962,243
Net income		-	-	8,531,705	-	-	8,531,705	-	8,531,705
Dividends		-	-	(8,000,000)	-	-	(8,000,000)	-	(8,000,000)
Other reserves	20	-	-	-	(1,009,303)	-	(1,009,303)	-	(1,009,303)
Financial statements translation differences		-	-	-	-	(323,333)	(323,333)	-	(323,333)
Non-controlling interests		-	-	-	-	-	-	(84,917)	(84,917)
Balance at December 31, 2016		20,000,000	10,000,000	35,184,606	(2,555,879)	(2,888,322)	59,740,405	1,335,990	61,076,395

The accompanying notes from 1 to 37 form an integral part of these consolidated financial statements.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016

1 GENERAL

A) ESTABLISHMENT OF THE COMPANY

Saudi Telecom Company (the "Company") was established as a Saudi Joint Stock Company pursuant to the Royal Decree No. M/35, dated Dhul Hijja 24, 1418H (corresponding to April 21, 1998) which authorized the transfer of the telegraph and telephone division of the Ministry of Post, Telegraph and Telephone ("MoPTT") (hereinafter referred to as the "Telecom Division") with its various components and technical and administrative facilities to the Company, and in accordance to the Council of Ministers' Resolution No. 213 dated Dhul Hijja 23, 1418H (corresponding to April 20, 1998) which approved the Company's Articles of Association (the "Articles"). The Company was duly wholly owned by the Government of the Kingdom of Saudi Arabia (the "Government"). Pursuant to the Council of Ministers' Resolution No. 171 dated Rajab 2, 1423H (corresponding to September 9, 2002), the Government sold 30% of its shares.

The Company commenced its operation as the provider of telecommunications services throughout the Kingdom of Saudi Arabia (the "Kingdom") on Muharram 6, 1419H (corresponding to May 2, 1998), and received its Commercial Registration No. 1010150269 as a Saudi Joint Stock Company on Rabi Awal 4, 1419H (corresponding to June 29, 1998). The Company's head office is located in Riyadh.

B) GROUP ACTIVITIES

The main activities of the Group comprise the provision and introduction of telecommunications, information and media services, which include, among other things:

- a- Establish, manage, operate and maintain fixed and mobile telecommunication networks and systems.
- b- Deliver, provide, maintain and manage diverse telecommunication services to customers.
- c- Prepare the required plans and studies to develop, execute and provide telecommunication services from all technical, financial and managerial aspects. In addition, to prepare and execute training plans in the telecommunication field, provide or obtain consulting services which are directly or indirectly related to its business and activities.
- d- Expand and develop telecommunication networks and systems by utilizing the updated modern devices and equipment in telecom technology, especially in the field of providing and managing services.
- e- Provide information, technologies and systems that depend on customers' information, including preparing, printing and distributing phone and commercial directories, brochures, information, data and providing the required communication means to transfer (internet) services which do not conflict with the Council of Ministers' Resolution No. (163) dated 23/10/1418H, the general computer services, and any telecommunication activities or services the Company provides whether for media, trade, advertising or any other purposes the Company considers appropriate.
- f- Wholesale and retail trade, import, export, purchase, own, lease, manufacturing, marketing, selling, developing, design, setup and maintenance of devices, equipment, and components of different telecommunication networks including fixed, moving and special networks, computer programs and the other intellectual properties, in addition to providing services and contracting works that are related to the different telecom networks.
- g- Invest in the Company's real estate properties and the resulting activities, such as selling, buying, leasing, managing, developing and maintenance.

Moreover, the Group has the right to establish other companies and to join with other companies, entities, or other local or foreign bodies, that are engaged in similar activities or completing to its core business or that may assist the Group to achieve its purpose and the Group can acquire the entire of the related company or part of it.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

1) GENERAL (CONTINUED)

C) INVESTMENTS OF THE COMPANY

The Company has various investments in subsidiaries, associates and joint ventures collectively known for the financial statements' purposes as the "Group". The details of these investments are as follows:

<u>Company's Name</u>	<u>Ownership %</u>		<u>Treatment</u>
	<u>December 31,</u>		
	<u>2016</u>	<u>2015</u>	
<u>Subsidiaries:</u>			
(1) Arabian Internet and Communications Services Co. Ltd. (STC Solutions) - Kingdom of Saudi Arabia	100%	100%	Full Consolidation
(2) Telecom Commercial Investment Company Ltd. – (TCIC) - Kingdom of Saudi Arabia	100%	100%	Full Consolidation
(3) VIVA Bahrain (BSCC) – Kingdom of Bahrain	100%	100%	Full Consolidation
(4) Aqalat Company Limited (Aqalat) – Kingdom of Saudi Arabia	100%	100%	Full Consolidation
(5) Public Telecommunication Company - (BRAVO) – Kingdom of Saudi Arabia	100%	100%	Full Consolidation
(6) Sapphire Company Ltd., – (Sapphire) - Kingdom of Saudi Arabia	100%	100%	Full Consolidation
(7) Intigral Holding Company (Intigral) – Kingdom of Bahrain	71%	71%	Full Consolidation
(8) Sale Advanced Co. Ltd. – (Sale Co.) - Kingdom of Saudi Arabia (see Note 35)	60%	60%	Full Consolidation
(9) Kuwait Telecom Company (VIVA) (KJC) - Kuwait	51.8%	26%	Full Consolidation
<u>Joint ventures and associate companies:</u>			
(10) Oger Telecom Ltd. – (OTL) – United Arab Emirates	35%	35%	Equity Method
(11) Binariang GSM Holding – (Binariang) Malaysia	25%	25%	Equity Method
(12) Arab Submarine Cables Company Limited. - Kingdom of Saudi Arabia	50%	50%	Equity Method
(13) Arab Satellite Communications Organization (Arabsat) - Kingdom of Saudi Arabia	36.66%	36.66%	Equity Method
(14) Contact Centers Company – (CCC) Kingdom of Saudi Arabia	49%	50%	Equity Method
(15) Virgin Mobile Saudi Consortium LCC – (VMSC) - Kingdom of Saudi Arabia	10%	10%	Equity Method

(1) Arabian Internet and Communications Services Co. Ltd. (STC Solutions) - Kingdom of Saudi Arabia

The Arabian Internet and Communications Services Co. (a limited liability company) was established in April 2002. The company is engaged in providing internet services, operation of communications projects and transmission and processing of information in the Saudi market. In December 2007, the Company acquired 100% of its SR 100 million share capital.

(2) Telecom Commercial Investment Company Ltd. – (TICI) Kingdom of Saudi Arabia

Telecom Commercial Investment Company (a limited liability company) was established in the Kingdom of Saudi Arabia in October 2007 by the Saudi Telecom Company with a share capital of SR 1 million, and which owns 100% of the company's share capital. The company operates in the Saudi market and was established for the purpose of operation and maintenance of telecommunication networks, computer systems' networks and internet networks, maintenance, operation and installation of telecommunication and information technology systems and programs.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

1) GENERAL (CONTINUED)

C) INVESTMENTS OF THE COMPANY (CONTINUED)

(3) VIVA Bahrain (BSCC) – Kingdom of Bahrain

VIVA Bahrain (BSCC) was established in the Kingdom of Bahrain in February 2009 by the Saudi Telecom Company with a share capital of BHD 75 million and the Saudi Telecom Company owning 100% of its share capital (which is equivalent to approximately SR 746 million at the exchange rate as at that date). This company operates in the field of all mobile telecommunication services, international telecommunications, broadband and other related services in the Bahraini market, and commenced its commercial operation on March 3, 2010.

(4) Aqalat Limited Company (Aqalat) – The Kingdom of Saudi Arabia

Aqalat Limited Company was established in the Kingdom of Saudi Arabia in March 2013 by the Company owning 100% of its SR 10 million share capital. Aqalat operates in the field of establishing, owning, investing, managing of real estate and contracting, and providing consulting services, and importing and exporting services to the benefit of the Company.

(5) Public Telecommunication Company “BRAVO” – Kingdom of Saudi Arabia

Public Telecommunication Company “BRAVO” was established in February 2002 in the Kingdom of Saudi Arabia. The Company acquired 100% of its SR 200 million share capital in January 2014. BRAVO operates in the electrical business and communication networks, wholesale and retail trade in fixed telecommunications equipment, electrical appliances, import, marketing, installation and maintenance of fixed and mobile telecommunications and information technology licensed devices.

(6) Sapphire Company Ltd. (Sapphire) – Kingdom of Saudi Arabia

Sapphire Company Ltd. was established in the Kingdom of Saudi Arabia in June 2014 with share capital amounting to SR 100 million. The Company owns 100% of Sapphire share capital. Sapphire operates in the retail and wholesale trade of computer systems and devices, fixed and mobile telecommunication, internet equipment, advertising and publicity material, spare parts, electrical equipment, automatic payment equipment, automatic points of sale equipment, selling of telecommunication operator’s services, establish telecom and sales centers, and services’ sales.

(7) Intigral Holding Company (BSCC) (Intigral) – Kingdom of Bahrain

Intigral Company was established as a holding company which owns shares in companies operating in the field of content services and digital media in Gulf countries in June 2009 in the Kingdom of Bahrain with share capital amounting to BHD 28 million which is equivalent to approximately SR 281 million at the exchange rate as at that date. The Saudi Telecom Company used to own 51% of Intigral Holding Company’s share capital. In December 2011, the Saudi Telecom Company increased its shareholding interest by 20% to reach 71%. On 20/12/1437 H corresponding to 21/09/2016 the Company board of directors approved to buy the shareholding of First Asia Digital Media Limited, (owned by Astro Malaysia) in Intigral, which represents 29% of the share capital of Intigral for a consideration of USD 10 million (equivalent to SR 37.5 million). Upon completion of the transaction, the Group will own 100% of Intigral’s share capital.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

1) GENERAL (CONTINUED)

C) INVESTMENTS OF THE COMPANY (CONTINUED)

(8) Sale Advance Co. Ltd (SaleCo.) – The Kingdom of Saudi Arabia

Sale Advanced Co. Ltd. – (Sale Co.) was established in the Kingdom of Saudi Arabia in January 2008 and operates in the wholesale and retail trade of recharge card services, telecommunication equipment and devices, computer services, sale and re-sale of all fixed and mobile telecommunication services, and commercial centers' maintenance and operation. SaleCo operates in the Saudi Market with branches in Bahrain and Oman. The Company acquired 60% of SaleCo SR 100 million share capital in December, 2011. On December 25, 2015, the Company's board of directors have agreed to provide an offer to acquire Ethad Sale's stake in Sale Advanced Co. Ltd. (Saleco), which represent 40% of the Saleco's shares, for an amount of SR 400 million. On January 17, 2017 the necessary procedures for the purchase and transfer of ownership of the remaining shares in Sale Advanced Company (Sale Co.) was completed, which represents 40% of its capital and thus become fully owned 100% by the Company (see Note 35).

(9) Kuwait Telecom Company (VIVA) (KJC) - Kuwait

In December 2007, the Saudi Telecom Company acquired 26% of the KD 50 million share capital of the Kuwait Telecom Company, equivalent to approximately SR 687 million at the exchange rate as at that date, this company operates in the field of mobile services in the Kuwaiti market, and commenced its commercial operation on December 4, 2008. It was listed as a joint stock company in Kuwait Stock Exchange on December 14, 2014. Saudi Telecom Group manages Kuwait Telecom Company (VIVA) and treats its investment in it by using the full consolidation method due to its control over the financial and operating policies. Group representation on the board of the Kuwaiti Telecom Company constitutes a majority of the members.

On December 27, 2015, the Company has submitted a voluntary offer to acquire the issued shares of Kuwait Telecom Company (VIVA) not already owned by STC, which represents 74% of VIVA, issued shares. The offer presented by the Company to VIVA's shareholders amounted to Kuwaiti Dinar 1 per share (equivalent to SR 12.37). The period of this offer ended on January 31, 2016, and the number of shares that accepted the offer accumulated to 128,860,518 shares which represent 25.8% of total issued shares to Kuwaiti Telecom Company (VIVA). The total value of those share KD 128, 860,518 (which is equivalent to SR 1,590,138,792) and thus the Company's share in Kuwait Telecom Company (VIVA) is 51.8% instead of 26% (see Note 34).

(10) Oger Telecom Company Ltd. (OTL) - U.A.E.

Oger Telecom Ltd. is a Holding company registered in Dubai, the United Arab Emirates, having investments in companies operating primarily in the telecommunications sector in Turkey and South Africa. The Company acquired 35% of OTL's USD 3.6 billion share capital, equivalent to approximately SR 13.5 billion in April 2008 at the exchange rate as at that date (see Note 7).

(11) Binariang GSM Holding - Malaysia

Binariang is a Malaysian investment holding company registered in Malaysia, and which owns 100% of Maxis (Malaysia Holding Group), an un-listed group operating in the telecommunications sector in Malaysia. On November 2009, 30% of Maxis' shares were offered for public subscription and the company was subsequently listed on the Malaysian stock market. Also, another share of 5% was sold in the month of July 2012. The percentage ownership of Binariang Holding in Maxis accordingly was reduced to 65%. Binariang Holding has other investments in India (Aircel Company).

On September 2007, Saudi Telecom Company acquired 25% of its MYR 20.7 billion share capital of Binariang Group, equivalent to approximately SR 23 billion at the exchange rate as at that date.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

1) GENERAL (CONTINUED)

C) INVESTMENTS OF THE COMPANY (CONTINUED)

(11) Binariang GSM Holding – Malaysia (continued)

During the year 2013, the STC Group conducted a review of its foreign investment in Binariang GSM holding group (joint venture), including the manner in which this investment is being managed and how joint control has been effectively exercised. As a result of such review, STC signed an amendment to the shareholders' agreement with other shareholders of Binariang GSM holding group with respect to certain operational matters of the Aircel group (a subsidiary of Binariang group). Consequently, it has been concluded that STC group shall stop to account for its investment in Aircel group using the equity method effective from the second quarter 2013.

(12) Arab Submarine Cables Company Limited. - Kingdom of Saudi Arabia

Arab Submarine Cables Company (a mixed limited liability company) was established on September 2002 for the purpose of constructing, leasing, managing and operating a submarine cable connecting the Kingdom of Saudi Arabia and the Republic of Sudan for the telecommunications between them and any other country. The operations of Arab Submarine Cables Company Ltd. started on the month of June 2003, and Saudi Telecom Company acquired 50% of its SR 75 million share capital in September 2002. Dated 24/11/2016 the Board of Directors approved on the recommendation of the Board of Directors of Arab submarine cables company to reduce the company share capital to SR 25 million by transferring cash available for partners in proportion to their ownership.

(13) Arab Satellite Communications Organization "Arabsat" – Kingdom of Saudi Arabia

This organization was established on April 1976 by member states of the Arab League. Arabsat offers a number of services to these member states, as well as to all public and private sectors within its coverage area, and principally in the Middle East. Current services offered include: Regional telephony (voice, data, fax and telex), television broadcasting, regional radio broadcasting, restoration services and leasing of capacity on an annual or monthly basis.

In April 1999, Saudi Telecom Company acquired 36.66% of Arabsat's USD 500 million share capital (equivalent to approximately SR 1,875 million at the exchange rate as of that date).

(14) Contact Center Company– The Kingdom of Saudi Arabia

Contact Center Company (a mixed limited liability company) was established to provide call centers services and answer directory queries with Aegis Company at the end of December 2010 in the Kingdom of Saudi Arabia, with a share capital of SR 4.5 million. In December, 2010, Saudi Telecom Group acquired approximately 50% of its SR 4.5 million share capital (225,001 owned shares out of 450,000 shares). During the fourth quarter of year 2015, the Company sold 1% of its stake in Contact Centers Company to the other partners according to the terms of the partners' agreement (220,500 owned shares out of 450,000 shares).

(15) Virgin Mobile Saudi Consortium LCC (VMSC) – Kingdom of Saudi Arabia

Virgin Mobile Saudi Consortium (Limited liability Company) or VMSC was established during the year 2013 as a mobile virtual network operator and started its operation during the year of 2014. The Company owns 10% of VMSC's SR 52 million share capital. The partners' agreement and the article of association of VMSC was amended to include a new partner during the year of 2015. This resulted into a reclassification of this investment from investment available for sale to investment in associate company accounted for using the equity method.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies are summarized below:

2-1 Basis of preparation and measurement

The accompanying consolidated financial statements are prepared in accordance with the accounting standards generally accepted in the Kingdom of Saudi Arabia issued by the Saudi Organization for Certified Public Accountants. The consolidated financial statements of the Group include the financial statements of the Company and its subsidiaries mentioned in Note 1.

The significant accounting policies used for the preparation of the consolidated financial statements mentioned below are consistent with the accounting policies detailed in the audited consolidated financial statements for the year ended December 31, 2015.

The consolidated financial statements are prepared under the historical cost convention except for investments held for trading and available for sale, and derivative financial instruments that are measured at fair value.

Effective 1 January 2017, the Company's financial statements will be prepared under International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and endorsed by the Saudi Organization for Certified Public Accountants ("SOCPA"). Upon IFRS adoption, the Company will be required to comply with the requirements of IFRS 1 - First-time Adoption of International Financial Reporting Standards for the reporting periods starting 1 January 2017. In preparing the opening IFRS financial statements, the Company will analyze impacts and incorporate certain adjustments due to the first time adoption of IFRS.

2-2 Basis of consolidation

Subsidiaries

Entities controlled by the Group are classified as subsidiaries. Control is defined as the power to use, or direct the use, of another entity's assets in order to earn economic benefits. The financial statements of the subsidiaries are included in the consolidated financial statements of the Group effective from the date control commences until the date it ceases.

Intra-group balances and transactions and any unrealized gains arising from intra-group transactions, if material, are eliminated in full in the consolidated financial statements.

2-3 Use of estimates

The preparation of the consolidated financial statements in conformity with the accounting standards generally accepted in the Kingdom of Saudi Arabia requires the use of accounting estimates and assumptions which affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the amounts of revenues and expenses during the reporting period of the consolidated financial statements.

2-4 Period of the consolidated financial statements

The Group's financial year begins on January 1 and ends on December 31 of each Gregorian year.

2-5 Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, bank balances and highly liquid investments with maturity of 90 days or less from the acquisition date. Otherwise, they are classified as short-term investments.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2-6 Short term investments

Short term investment include Islamic “Murabahas” with local, regional, and international banks with high credit rating for periods that do not exceed a year and no less than 91 days.

2-7 Accounts receivable

Accounts receivable are stated at their net realizable value, which represents billed and unbilled revenues net of allowance for doubtful debts.

The Group reviews its accounts receivable for the purpose of providing the required allowances against doubtful debts. When creating the allowance, consideration is given to the type of service rendered (mobile, landlines, data, international settlements, etc...), customer category, age of the receivable, and the Group’s experience in previous debts collection and the general economic situation.

2-8 Offsetting of accounts

The Group has agreements with international network operators and other parties to offset receivables and payables relating to the same operator on a periodic basis.

2-9 Inventories

Inventories, which principally comprise cables, spare parts and consumables, are stated at weighted average cost, net of allowances. Inventory items that are considered an integral part of the network assets, such as emergency spares, which cannot be removed from the switch, are recorded within the property, plant and equipment. Inventory items held by contractor responsible for upgrading and expanding the network are recorded within ‘capital work-in-progress’.

The Group creates an allowance for obsolete and slow-moving inventories, based on a study of the usage of the major inventory categories separately. When such an exercise is impractical, the allowance is based on groups or categories of inventory items, taking into consideration the items that may require significant reduction in their value.

2-10 Property, plant and equipment and depreciation

- 1) Prior to May 2, 1998, the Telecom Division did not maintain sufficiently detailed historical information to record property, plant and equipment based on historical cost. Consequently, all property, plant and equipment transferred by the Telecom Division on May 2, 1998 were recorded based on the independent valuation local and international valuation experts.

The principal bases used for valuation are as follows:

- Land	Appraised value
- Buildings, plants and equipment	Depreciated replacement cost

- 2) Except for what is mentioned in paragraph (1) above, property, plant and equipment acquired by the Group are recorded at historical cost.
- 3) Cost of the telecommunication network comprises all expenditures up to the customer connection point, including contractors’ charges, direct materials and labor costs up to the date the relevant assets are placed in service.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2-10 Property, plant and equipment and depreciation (continued)

- 4) Property, plant and equipment, excluding land, are depreciated using the straight line method over the following estimated useful lives of assets:

	<u>Number of Years</u>
Buildings	20 – 50
Network and telecommunication equipment	3 – 25
Other assets	2 – 20

- 5) Repair and maintenance costs are recognized as incurred, except to the extent that they increase productivity or extend the useful life of an asset, in which cases they are capitalized.
- 6) Gains and losses resulting from the disposal / sale of property, plant and equipment are determined by comparing the proceed with the book value of the disposed-off / sold assets, and the gains and losses are included in the consolidated statement of income.
- 7) Leases of property, plant and equipment where the Group transfers substantially all benefits and risks of ownership are classified as capital leases. Capital leases are capitalized at the inception of the lease at the lower of the fair value or the present value of the minimum lease payments. Each lease payment is to be allocated between the finance charge which is expensed in the current period and the reduction in the liability amount under the capital lease.
- 8) Assets leased under capital leases are depreciated over their estimated useful lives.
- 9) Assets under concession agreements (if any) are depreciated over their useful lives or the contract period whichever is shorter.

2-11 Software costs

- 1) Costs of operating systems and application software purchased from the vendor are capitalized if they meet the capitalization criteria, which include productivity enhancement or a noticeable increase in the useful life of the asset. These costs are amortized over the estimated period for which the benefits will be received.
- 2) Internally developed operating systems software costs are capitalized if they meet the capitalization criteria, which include the dedication of a defined internal work group to develop the software and the ability to readily identify related costs. These costs are amortized over the estimated period for which the benefits will be received.
- 3) Internally developed application software costs are recognized as expenses when incurred. When the costs of operating systems software cannot be identified separately from the associated computer hardware costs, the operating systems software costs are recorded as part of the hardware.
- 4) Subsequent additions, modifications or upgrades of software programs, whether operating or application packages, are expensed as incurred.
- 5) Computer software training and data-conversion costs are expensed as incurred.

2-12 Intangible assets

Goodwill

- Goodwill arises upon the acquisition of a stake in the subsidiaries. It represents the excess of the cost of the acquisition over the Group's share in the fair value of the net assets of the subsidiary at the date of purchase. When this difference is negative, it is immediately

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2-12 Intangible assets (continued)

recognized as gains in the consolidated statement of income in the period in which the acquisition occurred.

- Goodwill is recorded at cost and is reduced by any impairment losses (if any).

Spectrum rights and licenses

These intangible assets are recorded upon acquisition at cost and are amortized starting from the date of service on a straight-line basis over their useful lives or statutory duration, whichever is shorter. Licenses are amortized over periods ranging from 20 to 30 years.

2-13 Impairment of non-current assets

The Group reviews periodically non-current assets to determine whether there are indications that they may be impaired. When such indications are present, the recoverable amount of the asset is estimated. If the recoverable amount of the asset cannot be determined individually, then the cash generating unit to which the asset relates is used instead. The excess of the carrying amount of the asset over its recoverable amount is treated as impairment in its value to be recognized in the consolidated statement of income of the financial period in which it occurs. When it becomes evident that the circumstances which resulted in the impairment no longer exist, the impairment amount (except for goodwill) is reversed and recorded as income in the consolidated statement of income of the financial period in which such reversal is determined. The amount of reversal shall not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in previous financial periods.

2-14 Investments

Investments accounted for under the equity method

a- Investments in joint ventures

A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity that is subject to joint control that is when the strategic financial and operating policy decisions relating to the activities of the joint venture require the unanimous consent of all the parties sharing control.

Contractual arrangements that involve a separate entity in which each venture has an interest are referred to as jointly controlled entities.

Goodwill arising on the acquisition of the Group's interest in a jointly controlled venture is accounted for as a portion of that investment when applying the equity method.

The Group records the investments in joint venture on acquisition at cost, and are adjusted subsequently by the Group's share in the joint ventures' net income (loss), distributed dividends and any changes in the joint ventures' equity, to reflect the Group's share in the investee's net assets. These investments are reflected in the consolidated statement of financial position as non-current assets, and the Group's share in the net income (loss) of the joint ventures is presented in the consolidated statement of income.

b- Investments in associates

Associates are those corporations or other entities on which the Group exercises significant influence, but which it does not control, generally accompanying a shareholding of 20% to 50% of the voting rights. Significant influence is the power to participate in the financial and operating policies of the associates but not the power to exercise control over those policies.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2-14 Investments (continued)

b- Investments in associates (continued)

The Company accounts for investments in entities in which it has a significant influence under the equity method. Under the equity method, the Company records the investments on acquisition at cost, and are adjusted subsequently by the Group's share in the net income (loss) of the investees, the investees' distributed dividends and any changes in the investee's equity, to reflect the Company's share in the investee's net assets. These investments are reflected in the consolidated statement of financial position as non-current assets, and the Company's share in the net income (loss) of the investees is presented in the consolidated statement of income.

c- Other investments

Available for sale marketable securities that do not lead to control or significant influence are carried at fair value, which is based on market value when available. However, if fair value cannot be determined for available for sale securities, due to non-availability of an active exchange market or other indexes through which market value can objectively be determined, its cost will be considered as the alternative fair value. Unrealized gains and losses, if material, are shown as a separate component within shareholders' equity in the consolidated statement of financial position. Losses resulting from permanent decline in fair value below cost are recorded in the consolidated statement of income in the period in which the decline occurs.

Gains and losses resulting from sale of available for sale securities are recorded in the period of sale, and previously recorded unrealized gains and losses are reversed in the consolidated statement of income.

Investment in financial securities held to maturity are recorded at the cost adjusted for amortization of premiums and accretion of discounts, if any. Losses resulting from permanent decline in fair value below costs are recorded in the consolidated statement of income in the period in which the decline occurs.

2-15 Zakat

The Group calculates and records the zakat provision based on the zakat base in its consolidated financial statements in accordance with Zakat rules and principles in the Kingdom of Saudi Arabia. Adjustments arising from final zakat assessment are recorded in the period in which such assessment is approved by the General Authority of Zakat and Tax.

2-16 Taxes

Tax relating to investee companies outside the Kingdom of Saudi Arabia is calculated in accordance with tax laws applicable in those countries.

Deferred taxes

Deferred tax of foreign entities are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilized. This involves a judgement relating to the future financial performance of the foreign entity in which the deferred tax assets have been recognised.

2-17 Provision for End of service benefits

The provision for employees' end of service benefits represents amounts due to the employees upon the termination of their contracts, in accordance with the terms and conditions of the laws applicable in the Kingdom of Saudi Arabia and the countries of foreign investee companies.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2-18 Foreign currency transactions

Functional and presentation currency

Items included in the consolidated financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency").

These consolidated financial statements are presented in Saudi Riyals.

Transactions and balances

Balances of monetary assets and liabilities denominated in foreign currencies of specific amounts are translated using rates of exchange prevailing at the consolidated statement of financial position date.

Gains and losses arising on the settlement of foreign currency transactions, and unrealized gains and losses resulting from the translation to Saudi Riyals of foreign currency denominated monetary balances are recorded in the consolidated statement of income.

Entities of the Group (translation of financial statements)

The results and financial positions of all Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities are translated at the exchange rate prevailing on the consolidated statement of financial position date.
- Items of shareholders' equity at acquisition (except retained earnings), are translated at the exchange rate prevailing on the acquisition date.
- Changes in the items of shareholders' equity (except retained earnings), are translated at the exchange rate prevailing on the date of occurrence.
- Retained earnings are translated as follows: retained earnings translated at the end of prior year plus net income for the period as per the translated consolidated statement of income less declared dividends within the period translated at the exchange rate prevailing on the date of declaration.
- Items in the consolidated statement of income are translated using the weighted average rate for the period. Significant gains and losses are translated at the exchange rate prevailing on the date of their occurrence.
- All resulting exchange difference, if material, is recognised as a separate component of shareholders' equity.

When those entities are partially sold or disposed of, exchange differences that were previously recorded in shareholders' equity are recognized in the consolidated statement of income as part of the gains or losses on sale.

2-19 Contingent liabilities

A contingent liability is a possible obligation which may arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group, or a present obligation that is not recognized because it is not probable that an outflow of resources will be required to settle the obligation. If the amount of the obligation cannot be measured with sufficient reliability, then the Group does not recognize the contingent liabilities but disclose it in the consolidated financial statements.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2-20 Revenue recognition

Revenue is recognized when it is probable that the economic benefits associated with the transaction will flow to the Group and the amount of revenue can be measured reliably. Revenue represents the fair value of consideration received or receivable for rendering services and equipment sales net of discounts.

The Company generates revenue mainly from the provision of telecommunications services, which comprises of usage charges, calls revenues, messaging, interconnection fees, graphic services, and fees of infrastructure, installation, operation, sales of appliances and other added services.

Revenue is recognized according to the following:

- Revenue for access charges, airtime usage and messaging is recognized as revenue as services are performed. Unbilled revenues resulting from services already provided are accrued at the end of each period and unearned revenue from services collected in advance but are to be provided in future periods is deferred.
- Prepaid service revenue is recognized based on actual usage of the prepaid credits. The unused prepaid credit is deferred until used by the customer or expired.
- Monthly subscription fees, that are not linked to the amount of use, are recognized according to the straight-line method over the term of service period.
- Revenue from arrangements with multiple deliverables is allocated based on the fair value relative to each individual deliverable.
- Revenue from interconnection of voice, roaming, and data traffic with other local and international telecommunications operators is recognized at the time the services are performed based on the actual recorded services and the agreed tariff.
- Revenue from sale of telecommunication equipment, and handsets etc. is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably.
- Charges billed in advance are deferred and recognized over the period in which the services are rendered.
- Service revenue rendered to customers is recognized upon collection when collectability is highly uncertain.

2-21 Customer loyalty program

The Group has a customer loyalty program that offers various rewards to retain customers. The grants participating customers with credit point balances at the time of postpaid bills collection or prepaid lines recharging. The credit points balances are then exchanged for various rewards. The allocated amount of the credit point balances is estimated using the fair value for the right to exchange them on receiving a discount for the Group's products or for products and services provided by third parties. The fair value is estimated using the historical weighted average value of the points redeemed. The allocated amount is deferred and recognized as revenues when the credit points are redeemed or expired.

2-22 Cost of services

Cost of services represents all costs incurred by the Group on rendering of services which are directly related to revenues generated from the use of the network, and are recognized in the period the services are rendered. Cost of services mainly include the following:

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2-22 Cost of services (continued)

- Government charges are the costs incurred by the Group for the rights to provide the telecommunications services including the use of the frequency spectrum.
- Access charges represent the costs to connect telecommunications services to international and local carriers' networks.

2-23 Selling and marketing expenses

Selling and marketing expenses represent all costs incurred by the Group, which are directly related to the marketing, distribution and sale of services. They are expensed as incurred when it is not possible to determine the relevant benefiting periods. Otherwise, they are charged to the relevant periods.

2-24 General and administrative expenses

General and administrative expenses represent all the operating expenses incurred by the Group that cannot be directly linked to the costs of services or selling and marketing expenses. They are expensed as incurred when it is not possible to determine the relevant benefiting periods. Otherwise, they are charged to the relevant periods.

2-25 Earnings per share

Earnings per share are calculated by dividing operating income, income from other operations (other income and expenses), and net income for the financial period, by the weighted average number of outstanding shares.

2-26 Financial derivatives

The Group uses derivative financial instruments to manage its exposure to interest rate and foreign exchange rates risk, including interest rate swaps and forward currency contracts. Derivatives are initially measured at fair value at the date the derivative contract is entered into and are subsequently re-measured at fair value at the date of each reporting period. The resulting gain or loss is recognized in the consolidated statement of income immediately unless the derivative is designated and is effective as a hedging instrument, in which event the timing of the recognition in the consolidated statement of income depends on the nature of the hedge relationship.

The Group designates certain derivatives as either hedges of the fair value of recognized assets and liabilities or an unrecognized commitment except for foreign currency risks (fair value of the hedge), hedge of variability in cash flows that are either attributable to particular risks associated with designated assets or liabilities or the foreign currency risks in an unrecognized firm commitments (cash flow hedge).

Changes in fair value of derivatives that are designated and qualify as fair value hedges are recognized in the consolidated statement of income, together with any changes in the fair value of the hedged assets or liabilities. In the case of cash flow hedges, the effective portion of changes in fair value of the derivatives that are designated and qualify as cash flow hedges is recognized in shareholder's equity. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of income.

Hedge accounting is discontinued when the Group either revokes the hedge relationship, the hedging instrument is sold, terminated, or exercised, or it no longer meets the requirements of hedge accounting. Any gain/loss accumulated remains in the shareholder's equity and is recognized in the consolidated statement of income when the transaction is no longer expected to occur.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2-27 Related parties

During the ordinary course of business, the Group deals with related parties, all transactions of relative importance with related parties are disclosed regardless of the presence or absence of balances for these transactions by the end of the financial period. Transactions of the same nature are grouped into a single disclosure, with the exception of separate disclosures for transactions, which are necessary to understand the impact of the related party transactions on the financial data of the Group.

3 CASH AND CASH EQUIVALENTS

Cash and cash equivalents on December 31 consists of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Current accounts at bank	1,862,656	1,441,699
Short-term Murabahas	<u>1,731,811</u>	<u>3,062,347</u>
	<u>3,594,467</u>	<u>4,504,046</u>

The Company invests a part of surplus cash in Murabaha deals with maturity periods of 90 days or less with several local banks. The average rate of commission on them during the year 2016 was 2.36 % (2015: 1.13 %). Total commissions earned on the balances during the year 2016 amounted to SR 26 million (2015: SR 15 million).

The commissions earned by subsidiaries on Murabahas amounted to SR 8.6 million (2015: SR 4.9 million).

4 SHORT-TERM INVESTMENTS

The Company also invests a part of surplus cash in Murabaha accounts with maturity periods of 91 days or more with several local banks. The average rate of return during the year 2016 was 2.75% (2015: 1.27%), and the total commissions earned on them during the year 2016 amounted to SR 481 million (2015: SR 198 million).

The commissions earned by subsidiaries on short-term Murabahas amounted to SR 18.1 million (2015: SR 13.4 million).

5 ACCOUNTS RECEIVABLE, NET

(a) Accounts receivable on December 31 consists of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Billed receivables	16,524,974	10,382,772
Unbilled receivables	<u>4,945,932</u>	<u>4,147,551</u>
	<u>21,470,906</u>	<u>14,530,323</u>
Allowance for doubtful debts	<u>(3,010,361)</u>	<u>(2,734,233)</u>
	<u>18,460,545</u>	<u>11,796,090</u>

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

5 ACCOUNTS RECEIVABLE, NET (CONTINUED)

The movement in the allowance for doubtful debts during the year is as follows:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Balance at January 1	2,734,233	1,878,506
- Additions (refer to Note 23)	874,728	1,714,542
	<u>3,608,961</u>	<u>3,593,048</u>
- Bad debts written-off during the year	(598,600)	(858,815)
Balance at December 31	<u>3,010,361</u>	<u>2,734,233</u>

(b) Since inception, the Company recognizes revenues from services rendered to particular customers upon collection and that is when collectability is highly uncertain. The Company is currently pursuing the collection of these revenues. Uncollected billed revenues from these customers for the year 2016 amounted to SR 84 million (2015: SR 68 million), with an annual average of SR 154 million for the seventeenth years preceding 2016.

(c) The Group has agreements with local and international network operators whereby amounts receivable from and payable to the same operator are subject to offsetting. At December 31, the net amounts included in accounts receivable, accounts payable, and accrued expenses balance were as follows:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Accounts receivable, net	<u>3,796,177</u>	<u>3,300,506</u>
Accounts payable and accruals, net	<u>4,923,180</u>	<u>4,241,061</u>

(d) Amounts receivable from Government entities as at December 31, 2016 amounted to SR 12,534 million (2015: SR 6,546 million), while amounts payable to Government entities as at December 31, 2016 amounted SR 3,784 million (2015: SR 2,010 million). The age of the receivable balances with government entities as of December 31 is as follows:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
One year or less	6,724,186	3,861,571
More than one year to two years	4,108,432	2,684,397
More than two years	1,701,086	-
	<u>12,533,704</u>	<u>6,545,968</u>

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

6 PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets on December 31 consists of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Accrued commissions and receivables	703,592	632,285
Inventories	486,483	789,701
Advances to suppliers	470,383	1,064,279
Accrued profit on Sukuk (See Note 8)	306,773	141,371
Deferred expenses	202,352	182,352
Prepaid rents	183,863	123,740
Employees' housing loans - current portion	96,732	112,225
Dues from government entities	67,647	410,091
Prepaid insurance	19,855	88,092
Others	784,046	342,430
	<u>3,321,726</u>	<u>3,886,566</u>

7 INVESTMENTS ACCOUNTED FOR UNDER EQUITY METHOD AND OTHERS

These investments on December 31 consist of the following:

(Thousands of Saudi Riyals)	<u>2016</u>		<u>2015</u>	
	<u>Ownership</u>		<u>Ownership</u>	
Investments in associate companies – Kingdom of Saudi Arabia:				
Arab Satellite Communications Organization (“Arabsat”)	36.66%	1,772,591	36.66%	1,594,614
Arab Submarine Cables Company Limited.	50%	44,235	50%	44,382
Contact Centers Company	49%	41,785	50%	45,021
Virgin Mobile Saudi Consortium LCC	10%	866	-	3,304
		<u>1,859,477</u>		<u>1,687,321</u>
Investments in joint ventures:				
Binariang GSM Holding - Malaysia	25%	4,442,170	25%	4,566,141
Oger Telecom Ltd. U.A.E.	35%	-	35%	486,656
		<u>4,442,170</u>		<u>5,052,797</u>
Other investments		<u>417,009</u>		<u>173,893</u>
Total investments in equity and other		<u>6,718,656</u>		<u>6,914,011</u>

Other investments include the Company’s investment in Venture Capital Fund which is a fund investing in emerging, small and medium-sized companies working in the fields of Communications and Information Technology in the Saudi market and other global markets, in the form of investment units. The Company invested an initial amount of USD 50 million equivalent to SR 187.5 million self-financing (fully paid) (2015: of which it only paid USD 37.5 million equivalent to SR 140.6 million). As of December 31, 2016, investment units owned by the Company were valued at SR 409.4 million (2015: SR 166.3 million). Among the companies in which the fund invested in is Careem Company.

Also, other investments include the Company's investments in Saudi Media Measurement Company, which started its operations in early 2014 in the business of providing media measurement for the

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

7 INVESTMENTS ACCOUNTED FOR UNDER EQUITY METHOD AND OTHERS (CONTINUED)

purpose of supplying the Media Market with correct and authentic information. The Company owns 10.42% of its SR 54 million share capital that is equivalent to approximately SR 5.6 million.

The Group has an equity investment in Oger Telecom Company Limited (Oger Telecom) of 35% that is accounted for using the equity method. During the fourth quarter of 2016 the entire Group's investment balance in Oger Telecom was depleted and the Group has stopped accounting for its investment using the equity method, however the Group's share in Oger Telecom losses which exceeded the investment carrying value amounted to (SR 446 million) and changes in other reserves amounted to (SR 256 million). Oger Telecom is currently facing financial difficulties to settle its current borrowings dues and its ability to comply with the financial covenants agreed with lenders. This has casted doubt over Oger Telecom ability to continue as a going concern. The Group is currently studying the available options for this investment in line with the Group's strategy.

8 INVESTMENTS HELD TO MATURITY

In the second quarter of year 2014, the Company established diversified investing portfolios with several local and international banks with an amount of SR 4 billion for a period that does not exceed five years and with full capital protection. Further, in the fourth quarter of year 2014, the Company invested SR 1 billion in long term Murabaha with an international bank for a five-year term with an annual profit margin of 3%.

In December 2007, one of the subsidiaries invested 1,508 Malaysian Ringgit ("MR") (equivalent to SR 1,261 million) (2015: SR 1,315 million) in Sukuk for 50 years (callable after 10 years) with an annual profit margin of 10.75%. The Sukuk investment was financed by a floating rate, 10 years term loan denominated in MR, for an equivalent amount. At the same time as Sukuk investment and term loan, the underlying Sukuk and loan cash flows (coupons and financing cost only) were hedged for interest rate and foreign exchange risk. In 2015, the hedge agreement was unwound, and since Sukuk and term loan principal amounts are hedged for foreign exchange risk as both are dominated in Malaysian Ringgit, there is no effect on the income statement from the exchange rate fluctuations. As of December 31, 2016, the accrued profits (uncollected) from these Sukuk amounted to SR 306.8 million (2015: SR 141.3 million).

Comparative figures include investments amounted to BHD 16 million (equivalent to SR 159 million) for one of the subsidiaries of the Group which has been reclassified as a short term investments during 2016.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

9 PROPERTY, PLANT AND EQUIPMENT, NET

(Thousands of Saudi Riyals)	Land and Buildings	Telecommunications Network and Equipment	Other Assets	Capital Work in Progress	Total	
					2016	2015
<i>Total book value</i>						
- Balance at January 1	14,167,475	73,909,598	7,129,735	3,331,205	98,538,013	91,138,795
- Additions	68,261	5,723	15,878	9,464,742	9,554,604	9,071,160
- Transfers	335,350	8,387,354	728,286	(9,450,990)	-	-
- Disposals	(31,220)	(600,402)	(79,302)	-	(710,924)	(1,672,222)
- Translation differences	21	58	17	(1,030)	(934)	280
Balance at December 31	14,539,887	81,702,331	7,794,614	3,343,927	107,380,759	98,538,013
<i>Accumulated depreciation</i>						
- Balance at January 1	(7,710,678)	(45,572,621)	(4,767,123)	-	(58,050,422)	(52,910,098)
- Depreciation	(450,117)	(5,969,237)	(426,902)	-	(6,846,256)	(6,321,197)
- Disposals	28,558	493,267	24,116	-	545,941	1,181,089
- Translation differences	-	630	(19)	-	611	(216)
Balance at December 31	(8,132,237)	(51,047,961)	(5,169,928)	-	(64,350,126)	(58,050,422)
Net book value at December 31, 2016	6,407,650	30,654,370	2,624,686	3,343,927	43,030,633	
Net book value at December 31, 2015	6,456,797	28,336,977	2,362,612	3,331,205		40,487,591

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

9 PROPERTY, PLANT AND EQUIPMENT, NET (CONTINUED)

- (a) Land and buildings include land of SR 2,080 million as at December 31, 2016 (2015: SR 2,053 million).
- (b) In accordance with the Royal Decree referred to in Note (1), the ownership of assets had been transferred to the Company on May 2, 1998. However, the transfer of legal ownership of certain land parcels is still in progress. Land parcels for which legal ownership has been transferred to the Company' name amounted to SR 1,879 million as at December 31, 2016 (2015: SR 1,943 million). The transfer of the ownership of the remaining land parcels with a value of SR 114 million is still in progress (2015: SR 196 million).
- (c) Property, plant and equipment includes fixed assets belonging to certain investee companies that are pledged against bank borrowings and facilities for the investees for an amount of SR 93 million (2015: SR 96 million).
- (d) In 2014, the Company has received a resolution from the Ministry of Finance (MOF) requiring the expropriation of a land owned by the Company covering an area of 1,047,000 square meters and located in Alfaisaliah district in Riyadh. The compensation assessed by MOF amounted to SR 726 million and was collected during the first quarter of year 2015. Since the net book value of the relevant land and buildings amounted to SR 131 million, the Company realized a gain of SR 595 million. However, the Company objected to the compensation amount received because the land's assessed value is less than its estimated fair value. In December 2015, Riyadh Administrative Court issued a primary ruling to accept the Company's objection to the appreciation value in consideration of the expropriation of the land and therefore canceling the previous ruling made by the appreciation committee and allowing for a re-valuation of the land. On 21/12/2015 a final ruling was issued from the Administrative Court of Appeal in Riyadh and included support for primary judgment that judge to re-form a committee to evaluate the property.

10 INTANGIBLE ASSETS, NET

(Thousands of Saudi Riyals)	Licenses	Others	Total	
			2016	2015
Total book value				
- Balance at January 1	5,137,155	3,114,139	8,251,294	6,877,236
- Additions	112,461	835,385	947,846	1,373,125
- Disposal / Adjustments	-	(120,814)	(120,814)	-
- Translation differences	(48)	(1,699)	(1,747)	933
Balance at December 31	5,249,568	3,827,011	9,076,579	8,251,294
Amortization				
- Balance at January 1	(1,533,077)	(1,935,110)	(3,468,187)	(2,354,163)
- Amortization during the year	(443,743)	(772,871)	(1,216,614)	(1,113,172)
- Translation differences	32	1,752	1,784	(852)
Balance at December 31	(1,976,788)	(2,706,229)	(4,683,017)	(3,468,187)
Carrying value at December 31, 2016	3,272,780	1,120,782	4,393,562	
Carrying value at December 31, 2015	3,604,078	1,179,029		4,783,107

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Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

11 OTHER NON-CURRENT ASSETS

Other non-current assets on December 31 consist of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Employees' housing loans	358,899	496,902
Deferred expenses	227,559	393,144
Others	237,220	122,726
	<u>823,678</u>	<u>1,012,772</u>

“Other” mainly comprise advanced commissions, advanced fees and refundable deposits.

12 ACCOUNTS PAYABLE

Accounts payable on December 31 consists of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Government charges (see Note 5 (d))	3,783,741	2,009,990
Trade payables	1,071,478	1,786,521
	<u>4,855,219</u>	<u>3,796,511</u>

13 OTHER CREDIT BALANCES

Other credit balances - current on December 31 consists of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Deferred revenues – current	2,806,173	1,922,916
Provision for zakat and taxes (see Note 28)	1,349,873	1,574,266
Withholding tax provision	306,919	275,173
Early retirement program accruals	154,894	112,680
Customers' refundable deposits	131,430	78,491
Suppliers' retentions	65,840	118,511
Others	730,157	779,778
	<u>5,545,286</u>	<u>4,861,815</u>

“Others” mainly comprise social insurance dues, dividends payable, current portion of clubs' sponsorship liabilities and Settlement of seconded employees' entitlements.

Other credit balances - non-current on December 31 consists of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Deferred revenues – non-current	1,976,955	1,540,445
Others	274,669	624,329
	<u>2,251,624</u>	<u>2,164,774</u>

“Others” mainly comprise the non-current portion of clubs' sponsorship liabilities, suppliers' retentions and financial derivatives.

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Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

14 ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses on December 31 consist of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Trade accruals	1,994,985	1,597,471
Provision for liabilities and commitments	8,044,741	3,805,753
External networks' dues settlement	4,275,209	3,597,572
Capital expenditures	1,658,899	1,489,583
Employees' accruals	1,377,674	1,346,912
Others	431,212	315,687
	<u>17,782,720</u>	<u>12,152,978</u>

15 MURABAHAS

Murabahas on December 31 consist of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Current portion	1,864,027	1,903,087
Non-current portion	2,017,231	3,744,076
	<u>3,881,258</u>	<u>5,647,163</u>

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Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

15 MURABAHAS (CONTINUED)

The following table indicates the details of Murabaha as at December 31:

(Thousands of Saudi Riyals)			Outstanding balance			
			Current portion		Non-current portion	
Nature of Financing	Date of Financing	Date of Final Installment	2016	2015	2016	2015
Murabaha	April 2008	April 2018	110,000	110,000	55,000	165,000
Murabaha	April 2008	April 2018	555,556	555,556	277,778	833,333
Murabaha	April 2008	April 2018	388,889	388,889	194,444	583,333
Murabaha	September 2015	June 2018	40,963	41,220	20,481	61,831
Murabaha	July 2012	December 2021	5,370	5,368	85,920	91,252
Murabaha	July 2012	December 2017	144,550	132,095	-	144,479
Murabaha	July 2012	December 2017	223,395	204,146	-	223,279
Murabaha	December 2007	December 2017	-	-	1,261,145	1,315,486
Credit facilities	September 2015	June 2018	108,767	115,635	78,038	184,855
Credit facilities	September 2015	June 2018	102,267	102,911	44,425	141,228
Tawaruq	-	-	184,270	247,267	-	-
Total			1,864,027	1,903,087	2,017,231	3,744,076

- Some of the murabahas mentioned above are guaranteed “fully protected” with bonds and outstanding letters of credit.
- Current and non-current portion of Murabaha includes Murabaha with an amount of SR 91 million pledged against fixed assets.

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Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

16 SUKUK

In the second quarter of year 2014, the Company approved a Sukuk issuance program with a maximum amount of SR 5 billion. The first tranche has been issued as described in the following as at December 31, 2016:

<u>Issuance type</u>	<u>Issuance Date</u>	<u>Issuance Denomination</u>	<u>Issuance Total Amount</u>	<u>Maturity Date</u>
Telecom Sukuk	June 9, 2014	SR 1 Million	SR 2 Billion	June 9, 2024

The Sukuk described above have been issued at the face value without discount or premium. These Sukuk are interest bearing and are calculated on the basis of three months (SIBOR) plus 70 basis points margin payable every three months and for a period of 10 years.

17 PROVISIONS FOR END OF SERVICE BENEFITS

The movement in the provisions for end of service benefits during the year is as follows:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Balance at January 1	4,075,625	3,768,489
Additions during the year	575,216	530,189
Settlements/Adjustments during the year	(436,818)	(223,053)
Balance at December 31	<u>4,214,023</u>	<u>4,075,625</u>

The provision is calculated on the basis of vested benefits to which the employees are entitled should they leave at the balance sheet date, using the employees' latest salaries and allowances and years of service. The Group's companies use benefits programs which comply with the laws applicable in their countries.

18 SHARE CAPITAL

The Company's capital amounts to SR 20,000 million, divided into 2,000 million fully paid shares at par value of SR 10 each. As at December 31, 2016 and 2015, the Government owned 70% of the Company's shares.

19 STATUTORY RESERVE

As per the Company's Articles of Association, 10% of net income is appropriated as statutory reserve until such reserve equals 50% of issued share capital. This reserve is not available for distribution to the Company's shareholders. Based on the approval of the Ordinary General Assembly of Shareholders at its meeting on Rabi Thani 23, 1432 H corresponding to March 28, 2011 it was approved to cease the transfer of statutory reserve since it has reached the legal limit.

20 OTHER RESERVES

Other reserves on December 31 consists of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Hedging reserves	188,496	132,187
Other reserves (See Note 34)	2,367,383	1,414,389
	<u>2,555,879</u>	<u>1,546,576</u>

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Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

21 REVENUE FROM SERVICES

Revenue from services consists of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Usage charges	28,799,935	29,742,951
Subscription fees	21,714,403	19,705,658
Activation fees	182,384	130,733
Others	1,135,950	1,071,270
	<u>51,832,672</u>	<u>50,650,612</u>

22 COST OF SERVICES

Cost of services consists of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
External networks' usage charges	7,714,830	6,387,435
Government charges (*)	4,475,826	4,435,478
Repair and maintenance	2,926,805	2,929,784
Employees' costs	2,206,520	2,067,184
Cards recharge and printing cost	1,765,372	1,786,726
Rents of equipment, property and vehicles	948,171	994,583
Others	3,022,667	1,704,603
	<u>23,060,191</u>	<u>20,305,793</u>

“Others” mainly comprise expenses related to telecommunication services, postage, courier, security and safety expenses, premises expenses, and consultancy.

(*)The details of government charges are as follows:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Commercial service provisioning fees	3,667,257	3,631,415
Frequency spectrum fees	503,217	508,868
License fees	305,352	295,195
	<u>4,475,826</u>	<u>4,435,478</u>

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Company	4,189,017	4,147,445
Subsidiaries	286,809	288,033
	<u>4,475,826</u>	<u>4,435,478</u>

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

23 SELLING AND MARKETING EXPENSES

Selling and marketing expenses consist of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Employees' costs	2,453,159	2,347,319
Sales commission and incentives	1,020,686	820,274
Provision for doubtful debts	874,728	1,714,542
Advertising and publicity	586,403	725,283
Call center managing expenses	364,195	366,531
Repair and maintenance	245,176	134,347
Printing of telephone cards and office equipment	128,784	191,700
Others	704,892	898,742
	<u>6,378,023</u>	<u>7,198,738</u>

“Others” mainly comprise: Consultancies, legal and professional fees rent of equipment, property, and motor vehicles, security and safety, telecommunication expenses, postage, courier, utilities expenses and sport activities sponsorship costs.

24 GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses consist of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Employees' costs	2,186,393	2,069,768
Repair and maintenance	708,514	548,479
Rents of equipment, property and vehicles	349,316	307,923
Consultancies, legal and professional fees	290,376	336,378
Premises expenses	109,131	55,914
Security and safety expenses	97,270	92,014
Others	689,911	441,954
	<u>4,430,911</u>	<u>3,852,430</u>

“Others” comprise various items, the main ones being: insurance premiums, office supplies, freight, handling, postage, and courier expenses.

25 DEPRECIATION AND AMORTIZATION

Depreciation and amortization consist of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Depreciation (see Note 9)	6,846,256	6,321,197
Amortization (see Note 10)	1,216,614	1,113,172
	<u>8,062,870</u>	<u>7,434,369</u>

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Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

26 FINANCE COSTS

Finance costs comprise the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Company	97,677	64,523
Subsidiaries	105,981	173,887
	<u>203,658</u>	<u>238,410</u>

27 OTHER, NET

Other expenses and income, net consist of the following:

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Miscellaneous revenues	1,227,534	757,441
Losses on sale or disposal of property, plant and equipment	(131,208)	(360,193)
Miscellaneous expenses	(1,447,624)	(1,194,025)
	<u>(351,298)</u>	<u>(796,777)</u>

- Miscellaneous revenues for the year ended December 31, 2016 mainly include : Contracts under construction revenues amounting to SR 542 million (2015: SR 225 million) and contracts delay penalties amounting to SR 121 million (2015: SR 178 million). Comparative figures include gains of SR 91 million resulting from the acquisition of a subsidiary.
- Miscellaneous expenses for the year ended December 31, 2016 mainly include commitments and contingencies provision expense amounting to SR 675 million (2015: SR 140 million). Comparatives figures include a two-month salary of SR 395 million paid to the Company's employees following a Royal Decree.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

28 ZAKAT AND TAXATION PROVISION

(a) Zakat base

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Share capital – beginning of the year	20,000,000	20,000,000
<u>Additions:</u>		
Retained earnings, statutory reserve and provisions – beginning of the year	49,958,594	47,829,118
Borrowings and payables	5,715,473	8,892,725
Adjusted net income	14,205,053	11,181,514
Adjusted total shareholders' equity	89,879,120	87,903,357
<u>Deductions:</u>		
Net property (adjusted) and investments	53,917,279	53,073,347
Dividends paid	8,031,468	8,018,959
Deferred expenses and other balances	812,077	1,217,620
Total adjusted deductions	62,760,824	62,309,926
Zakat base	27,118,296	25,593,431
Zakat on fully owned ownership companies	677,957	639,836
Add: Zakat on partially owned companies	72,708	55,973
Total zakat provision for the year	750,665	695,809

(b) Zakat provision

(Thousands of Saudi Riyals)	<u>2016</u>	<u>2015</u>
Balance at January 1	1,573,496	1,438,662
Charge for the year	750,665	695,809
Amounts paid during the year	(680,620)	(560,975)
Adjustment during the year	(294,489)	-
Balance at December 31	1,349,052	1,573,496

Final zakat declarations were submitted for the years since inception through 2015. Effective from the year 2009, the Company started the submission of one zakat declaration for the Company and its fully-owned subsidiaries (whether owned directly or indirectly) in accordance with the Ministerial Decree No.1005 dated 28/4/1428H.

Final zakat assessments were received for the years since inception through 2011. The Company submitted objections for the year 2008 through 2011. The total zakat differences for these objections amounted to SR 1 billion. These objections are still outstanding with the General Authority of Zakat and Tax (GAZT) and the primary objection and appeal committees as at the reporting date of these interim consolidated financial statements. On 28/02/1438 H, the Appellate Committee through its decision No. 1642 for the year 1438 agreed the resumption of the company for the year 2007 and that through canceling the comparison process between Zakat declaration and adjusted income, whichever is greater. Such decision has strengthened the Company's position in relation to the objections with respect to subsequent years. Accordingly, the Company has settled the provision noting that the differences resulting from this comparison represents the major portion of the differences that are being objected. The Company's management believes that the result of these objections will be favorable to the Company and will not result in additional provisions.

Zakat assessments for the years from 2012 until 2015 are still under study of GAZT as at the reporting date of these consolidated financial statements.

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Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

28 ZAKAT AND TAXATION PROVISION (CONTINUED)

(c) Tax Provision

The tax amount shown in the consolidated statement of income represents the Group's share of taxes charged on subsidiaries in accordance with tax laws applicable in their countries. The tax expenses for the year ended on December 31, 2016 amounted to SR 132 thousand (2015: SR 1,035 thousand) and the balance of the provision as at December 31, 2016 amounted to SR 821 thousand (2015: SR 770 thousand).

During 2016, the Company received from the GAZT a withholding tax assessment on international operators networks rentals outside Saudi Arabia for the years from 2004 to 2015 for an amount of SR 3.1 billion. As the Saudi tax regulations do not cover withholding tax on the rental of international operators' networks as well as a recognition of source of income outside Saudi Arabia, management believes that this service should not be subject to taxation. Accordingly, the Company has submitted its objection to the withholding tax assessment. Based on the opinions of specialists, the nature of the services and existing provisions of the Saudi tax regulations, the Company's management believes that the result of these objections will be favorable to the Company and will not result to any additional provision.

29 RELATED PARTY TRANSACTIONS

Government entities in the Kingdom of Saudi Arabia

The Company provides various services to the Government such as voice, data transfer and other services.

The revenues and expenses related to Governmental entities in 2016 (including Government charges disclosed in Note 22 above) amounted to SR 4,428 million and SR 4,190 million, respectively (2015: SR 3,387 million and SR 4,158 million, respectively).

As at December 31, 2016, accounts receivable from and accounts payable to Government entities totaled SR 12,534 million and SR 3,784 million, respectively (2015: SR 6,546 million and SR 2,010 million, respectively) See Note 5).

Joint ventures and associates

Transactions and the outstanding balances with joint ventures and investments accounted for under the equity method during the year were not material except for the investment in Sukuk amounting to SR 1,261 million (2015: SR 1,315 million) (See Note 8).

Subsidiaries

The related parties transactions with subsidiaries during the year amounted to SR 19,815 million and the outstanding balances were SR 5,097 million as at December 31, 2016 (2015: transactions amounted to SR 22,598 million and the outstanding balances amounted to SR 4,985 million). All intra-group transactions and balances are eliminated at consolidation.

30 COMMITMENTS AND CONTINGENCIES

Commitments

- (a) The Group enters into commitments in the ordinary course of business for major capital expenditures, primarily in connection with its network expansion programs. Outstanding capital expenditure commitments amounted to SR 4,424 million as at December 31, 2016 (2015: SR 3,501 million).

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

30 COMMITMENTS AND CONTINGENCIES (CONTINUED)

Commitments (continued)

(b) Certain lands and buildings, for use in the Group's operations, are leased under operating lease commitments expiring at various future dates. The following schedule present operating lease commitment:

(Thousands of Saudi Riyals)	2016	2015
During 12 months	511,723	535,914
From 2 to 5 years	1,015,666	1,137,232
More than 5 years	344,134	413,707

(c) One of the subsidiaries has an agreement to invest in a fund aiming to improve the telecommunication and internet environment in the gulf region for USD 300 million (equivalent to SR 1,125 billion).

Contingencies

- The Group has outstanding letters of guarantee as at December 31, 2016 amounting to SR 3,224 million (2015: SR 3,159 million).
- On January 18, 2017, the Company received confirmation request letter from the Communications and Information Technology Commission (CITC) for an amount of SR 8,987 million. This amount includes government charges required to be paid by the Company on a regular basis in addition to other material amounts that are under dispute between the Company and CITC in relation to calculation method of government charges. The dispute relates to the telecommunications sector in the Kingdom as part of its normal operations and does not pertain to the Company only. However, based on independent legal opinions and similar judicial rulings in the telecommunication market in the Kingdom, the Company's management believes that these amounts are invalid. Furthermore, the Company is currently claiming to refund material government fees paid for previous years to CITC that is also related to the same method of government charges. Accordingly, based on the nature of these disputes and provisions that are recorded, the Company's management does not believe that this dispute will result in any additional material provisions in the future.
- The Group has outstanding letters of credit as at December 31, 2016 amounting to SR 505 million (2015: SR 536 million).
- One of the subsidiaries of the Group has an agreement with one of its key customers to construct a fiber optic network for which capital work completed amounted to SR 577 million and amounts received from the key customer amounted SR 742 million and recorded as 'deferred revenues' in the Group's balance sheet. On 21/03/2016, the Company received a letter from the customer requesting a refund for all paid balances. Based on the independent legal opinion obtained, the management believes that the customer's claims have no merit and therefore this dispute has no material impact on the financial results of the Group.
- The Company, in its ordinary course of business, is subject to proceedings, lawsuits and other claims. However, these matters are not expected to have a material impact neither on the Company's financial position nor on the results of its operations as reflected in these consolidated financial statements.

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Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

31 FINANCIAL INSTRUMENTS

Fair value

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. The management does not believe that the fair value of the Group's financial assets and liabilities differ materially from its carrying value as at December 31, 2016 and 2015.

Commission rate risk

Commission rate risk comprises various risks related to the effect of changes in commission rates on the Group's financial position and its cash flows. The Group manages its cash flows by controlling the timing between cash inflow and outflow. Surplus cash is invested to increase the Group's commission income through holding balances in short-term and long-term deposits and Murabahas. However, the related commission rate risk is not considered to be significant.

Currency risk

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. Management monitors fluctuations in foreign currency exchange rates and enters into hedging agreements when needed to reduce the foreign currency exchange rates risk. The official currency of the Group is the Saudi Riyal, the base currency dealing by the Group and its price is currently fixed with a minor margin against the U.S. dollar.

Credit risk

Credit risk is the risk that other parties will fail to discharge their obligations to the Group and cause the Group to incur a financial loss. Financial instruments that subject the Group to concentrations of credit risk consist primarily of cash balances and accounts receivable. The Group deposits its cash balances with a number of major high credit-rated financial institutions and has a policy of limiting its balances deposited with each institution. The Group does not believe that there is a significant risk of non-performance by these financial institutions. The Group does not consider itself exposed to a concentration of credit risk with respect to accounts receivable due to its diverse customer base (residential, professional, large commercial business and public entities) operating in various industries and located in many regions.

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity is managed by periodically ensuring its availability in amounts sufficient to meet any future commitments when they become due. The Group does not consider itself exposed to significant risks in relation to liquidity.

32 SEGMENT INFORMATION

- According to the main activities of the Group

The Group has identified its main operating segments by the type of service provided by the Group and transactions between operating segments occur in accordance with the normal trade provisions and terms. There are no other substantial revenues or expenses between segments.

The main operating segments of the Group comprise:

- GSM, for which the main services are: mobile, third and fourth generation services, prepaid cards, international roaming and messages.
- PSTN, for which the main services are: fixed line, card telephones, interconnect and international calls.
- DATA, for which the main services are: leased data transmission circuits and DSL.
- Un-allocated, pertains to services which could not be linked with the main operating segments of the Group.

Saudi Telecom Company (a Saudi Joint Stock Company)

Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

32 SEGMENT INFORMATION (CONTINUED)

- According to the main activities of the Group (continued)

The following table shows the information according to the Group's main activities for the year ended December 31, 2016:

(Thousands of Saudi Riyals)	<u>GSM</u>	<u>PSTN</u>	<u>DATA</u>	<u>Un-allocated /adjusted</u>	<u>TOTAL</u>
Revenue from services	35,232,427	6,655,295	9,718,160	226,790	51,832,672
Interconnect revenues	776,404	8,202,068	1,553,096	-	10,531,568
Interconnect expenses	(4,813,408)	(1,340,948)	(4,377,212)	-	(10,531,568)
Net revenues from services	<u>31,195,423</u>	<u>13,516,415</u>	<u>6,894,044</u>	<u>226,790</u>	<u>51,832,672</u>
Depreciation and amortization	3,165,305	4,083,799	515,086	298,680	8,062,870
Net income/(loss)	10,410,447	(3,593,547)	2,283,521	(568,716)	8,531,705
Total assets	27,340,748	29,274,061	21,332,299	23,659,417	101,606,525
Total liabilities	18,987,318	13,378,406	6,198,784	1,965,622	40,530,130

The following table shows the information according to the Group's activities for the year ended December 31, 2015 as follows:

(Thousands of Saudi Riyals)	<u>GSM</u>	<u>PSTN</u>	<u>DATA</u>	<u>Un-allocated /adjusted</u>	<u>TOTAL</u>
Revenue from services	37,518,388	5,859,544	7,181,971	90,709	50,650,612
Interconnect revenues	966,493	7,882,697	1,408,866	-	10,258,056
Interconnect expenses	(5,005,373)	(1,472,333)	(3,780,350)	-	(10,258,056)
Net revenue from services	<u>33,479,508</u>	<u>12,269,908</u>	<u>4,810,487</u>	<u>90,709</u>	<u>50,650,612</u>
Depreciation and amortization	3,152,428	3,281,579	725,710	274,652	7,434,369
Net income/(loss)	10,879,423	(1,940,134)	1,149,961	(830,822)	9,258,428
Total assets	33,716,590	26,001,867	14,450,669	22,491,983	96,661,109
Total liabilities	17,327,455	8,950,025	5,362,763	3,058,623	34,698,866

- According to Group operations

The Group has divided its operations into domestic and international operations. The following table shows the segmental information according to Group operations during the year ended December 31:

2016

(Thousands of Saudi Riyals)	Domestic Operations		International Operations	
	KSA	VIVA Bahrain	Intigral Holding Company	Kuwait Telecom Company (VIVA)
Operating revenues (*)	47,917,281	1,457,752	298,079	3,437,049
Total assets (**)	117,227,023	2,168,243	333,025	3,286,430

*The financial statements consolidation adjustments relating to the revenues amounted to SR (1,277,489) thousand.

** The financial statements consolidation adjustments relating to the assets amounted to SR (21,408,196) thousand.

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Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

32 SEGMENT INFORMATION (CONTINUED)

- According to Group operations (continued)

(Thousands of Saudi Riyals)	2015			
	Domestic Operations	International Operations		
	KSA	VIVA Bahrain	Intigral Holding Company	Kuwait Telecom Company (VIVA)
Operating revenues (*)	46,829,158	1,434,917	322,914	3,422,209
Total assets (**)	109,647,160	2,294,768	450,324	3,253,799

*The financial statements consolidation adjustments relating to the revenues amounted to SR (1,358,586) thousand.

** The financial statements consolidation adjustments relating to the assets amounted to SR (18,984,942) thousand.

33 DIVIDENDS

In line with the dividends policy for the next three-year period that started from the fourth quarter of 2015 and that has been approved by the Company's Board of Directors on 28 Muharram 1437H (corresponding to 10 November 2015) and endorsed by the General Assembly on 4 April 2016. The dividend policy is based on maintaining a minimum dividend representing SR 1 per share on quarterly basis. The Company will distribute cash dividends to the shareholders for the fourth quarter of year 2016 with an amount of SR 2,000 million representing SR 1 per share. During the year, the Company has distributed cash dividends to shareholders for the first and second quarters of 2016 amounting to SR 2,000 million for each quarter representing SR 1 per share. The total distributed dividend for the year 2016 amounted to SR 4 per share (2015: SR 4 per share).

34 SUBSIDIARY OWNERSHIP INCREASE (KUWAIT TELECOM COMPANY "VIVA")

On January 31, 2016, the allotted time period for the voluntary offer submitted by the Company to acquire the remaining 74% issued shares of Kuwait Telecom Company (VIVA) not already owned by STC, has ended. The number of shares that accepted the offer accumulated to 128,860,518 shares that represent 25.8% of total issued shares of VIVA. The total value of acquired shares amounted to Kuwaiti Dinar 128,860,518 (equivalent to SR 1,619,338 thousand). Hence, the Company's share in VIVA became 51.8% instead of 26.0%. As a result of this increase, the non-controlling minority interest decreased by SR 306 million and the equity (other reserves) by SR 1,313 million.

35 SUBSEQUENT EVENTS

- SUBSIDIARY OWNERSHIP INCREASE (SALE ADVANCED CO. LTD. – (SALE CO.))

On January 17, 2017, the necessary procedures for the purchase and ownership transfer of the remaining shares in Sale Advanced Company (Sale Co.) representing 40% of Sale Co.'s outstanding shares for SR 400 million were completed. Hence, starting the date of completion, Sale Co. is a wholly-owned subsidiary of Saudi Telecom Company.

- PURCHASE OF A 10% STAKE IN CAREEM COMPANY (CAREEM)

In January 2017, the Company completed the purchase of 10% stake in Careem for an amount of USD 100 million (equivalent to SR 375 million). Careem was founded in 2012 and provides innovative, fast and convenient transportation services through its website and smartphones application.

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Notes to the Consolidated Financial Statements for the Year Ended December 31, 2016 (continued)

36 FINANCIAL STATEMENTS APPROVAL

The Board approved in its meeting held on 22 Jumada Al Awla 1438 H (corresponding to 19 February 2017) the consolidated financial statements for the year 2016.

37 RECLASSIFICATION

Certain figures for the year ended December 31, 2015 have been reclassified to conform with the presentation used for the year ended December 31, 2016.